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BEFORE THE

Federal Communications Commission

WASHINGTON, DC 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of	)	
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Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers	)	CC Docket No. 95-185
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REPLY COMMENTS OF AIRTOUCH COMMUNICATIONS, INC.

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Table of Contents

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AIRTOUCH COMMUNICATIONS, INC.

AirTouch Communications, Inc.[1] ("AirTouch") hereby submits its reply comments regarding the Commission's Notice of Proposed Rulemaking in the above-captioned proceeding.[2] In the Notice, the Commission examines how its interconnection policies should promote the continued development of commercial mobile radio services ("CMRS") in competition with local exchange carrier ("LEC") services.

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1 Directly and through various partnerships, AirTouch is a major provider of cellular services. In addition, AirTouch is in the process of completing a merger of its cellular interests with those of U S WEST NewVector Group, Inc. Finally, AirTouch is a partner in an "A" and "B" Block PCS licensee, PCS PrimeCo., L.P. AirTouch Paging is one of the largest paging companies in the United States.

2 FCC 95-505 (rel. Jan.11, 1996) ("*NPRM*"). In an Order and Supplemental Notice (FCC 96-61, rel. Feb.16, 1996), the Commission extended the reply comment date in this proceeding to March 25, 1996.

I. SUMMARY

The Commission, Congress and the Administration share a vision of widespread telephony competition with services provided over a network of networks. The fair and efficient pricing of the local exchange bottleneck is central to the realization of this vision. The Commission must complete several fundamentally important tasks to develop a set of efficient, cost-based prices for local loop, interexchange access, LEC-CMRS interconnection, and the other services provided by local exchange networks. These tasks include: (1) developing reliable measures of LEC costs for each service; (2) allocating overheads and common costs among the different services that utilize local exchange facilities; and (3) developing and implementing a competitively neutral universal service mechanism. Until it completes all three tasks, the Commission cannot implement fully efficient prices; it will either lack the needed information or will be constrained by pricing distortions that are the legacy of policies that were appropriate in the days of a telephone monopoly, but are no longer appropriate today.

No one should minimize the difficulty of the tasks at hand. It will take considerable time and resources to complete them. Regardless, however, the steps outlined above must be completed before one can design and implement a fully satisfactory policy. In the interim, the Commission must choose among admittedly imperfect alternatives. While all of the options are imperfect, this does not mean that the interim choice is irrelevant. Some interim options are better than others.

The comments in response to the NPRM demonstrate that the following interim policy for the pricing of LEC-CMRS interconnection will do more to promote efficient competition than will any other available alternative:

- *Terminating Access.* The Commission was correct to conclude that a bill and keep arrangement represents the best interim solution with respect to terminating access from LEC end offices to LEC end-user subscribers and from equivalent CMRS facilities to CMRS subscribers. As discussed in the next two paragraphs, this logic should be extended to all transmission and switching within the respective networks.
- *Dedicated transmission facilities between CMRS MTSOs and LEC networks.* The Commission was correct to conclude that these facilities should be subject to non-traffic sensitive, capacity charges. There are, however, two areas in which the Commission's tentative conclusions should be modified: (1) the nature of pricing and cost sharing; and (2) the demarcation point for a LEC network. With respect to the first point, dedicated transmission facilities between LEC and CMRS networks generate benefits for subscribers to both networks, and thus LECs and CMRS providers should share equally the long-run incremental costs of dedicated transmission facilities. Turning to the second point, the Commission should direct LECs and CMRS providers each to designate a single point of interconnection for each defined service area (a Basic

Trading Area ("BTA"), for example).[3] These designated points would serve as the boundaries of the respective networks.[4] The LEC would be responsible for the costs associated with transmission and switching within its network, just as CMRS providers would be responsible for transmission and switching within their networks.

- *Tandem switching and common transport between tandem switches and end offices.* LECs and CMRS providers should be treated as co-carriers. Under the co-carrier model, each network is responsible for all transport and switching within its own network. Tandem switching and common transport between tandem switches and end offices are elements of service *within* a LEC's network, just as transport between a CMRS provider's different MTSOs, or between an MTSO and associated RF transmitter sites, are within the CMRS provider's network. The switching and transport within each network is the responsibility of the respective co-carrier and should be subject to bill and keep.

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3 The Commission defines the interconnection points as the CMRS providers' MTSO and the LECs' end offices. *NPRM, supra* note 2, at ¶ 63. Efficiency is better promoted by defining broader boundaries, such as BTAs, so that carriers have incentives to optimize their networks and minimize costs over a broader range of facilities.

4 As discussed below, the proposed policy would allow LECs and CMRS providers the freedom to negotiate additional interconnection points if doing so is in their joint interest.

This policy is comparatively simple to implement,[5] limits the LECs' ability to hinder the development of CMRS competition — including competition with local loop — and generates sound economic incentives for both LEC and CMRS provider decisions regarding investment in interconnection facilities between, and transport facilities within, their respective networks. Moreover, this policy establishes a fair and efficient basis upon which the private parties can negotiate to optimize interconnection arrangements on a case-by-case basis. In contrast, continuation of the status quo — the path favored by the LECs — would perpetuate current inequities and inefficiencies, and would slow the development of wireless local loop.

With respect to the jurisdictional issues, the 1993 Budget Act revisions to Sections 332 and 2(b) of the Act, particularly the addition of Section 332(c)(1)(B), expressly gave the Commission exclusive authority over interstate *and* intrastate LEC-CMRS interconnection. This jurisdictional shift away from the states was left undisturbed by Congress in the 1996 Act. Moreover, the comments demonstrate convincingly that, in an increasingly significant percentage of circumstances, CMRS and LEC networks do not have the technical capability to distinguish between interstate and intrastate calls. This "inseverability" problem provides a separate basis for the Commission to preempt state regulation of LEC-CMRS interconnection.

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[5] For instance, this policy: (1) avoids the need to conduct detailed cost studies of the components of both LEC and CMRS provider networks; (2) avoids the difficulties of implementing complex peak-load pricing schemes; and (3) does not give rise to the misincentives that are widely recognized to flow from regulation that allows carriers to recover their costs without regard for potential efficiency improvements.

II. STATE OF THE DEBATE

The comments in this proceeding show broad agreement on many of the fundamental principles that should underlie Commission policy making. In particular, there is widespread agreement that:

1. Long-run incremental cost provides the starting point for efficient cost-based pricing.
2. There may be a need to price services above long-run incremental cost in order to cover common costs and/or raise subsidy revenues.
3. Today's LEC-CMRS interconnection charges are not cost-based in either level or structure.
4. The benefits of interconnection accrue to the subscribers of both wireline and wireless networks.
5. There should be much greater harmonization of LEC-CMRS interconnection charges, interexchange access charges, enhanced service provider interconnection charges, and local service rates than at present.
6. Universal service needs to be fundamentally reformed to target subsidies and to attain competitively neutral funding and subsidy mechanisms.

While there is widespread agreement on the principles that should govern the design of a long-term solution, there is considerable disagreement about what should be the interim LEC-CMRS interconnection policy pending reform of local service, access, and universal service policies:

a. LECs generally argue that the current system is working and that policy makers should rely on private negotiations with the vague threat of government intervention sometime down the road if negotiations break down. The LECs argue that bill and keep suffers from a number of shortcomings.

b. CMRS providers generally argue that bill and keep, coupled with appropriate cost sharing, is a simple and fair interim measure that will promote the efficient development of the CMRS industry in general and wireless local loop in particular. CMRS providers argue that the current system gives rise to serious inefficiencies and inequities.

The next section of these reply comments demonstrates that the continuation of the status quo would not be a sound course for policy. Moreover, even if the Commission chooses to rely on private negotiations in the first instance, the Commission still must have a policy for resolving disputes when the private parties reach an impasse. There are strong public interest reasons for annunciating this policy sooner rather than later. Mandating that LECs recognize CMRS providers as co-carriers would provide a sound basis for resolving private disputes. Indeed, by providing the parties with certainty and the ability to predict how the Commission will resolve disputes, a clearly-stated policy makes the parties less likely to get to a point requiring regulatory intervention.

The following section addresses the LECs' objections to bill and keep. Analysis demonstrates that many of the LECs' objections are equally applicable to the current regime that they advocate continuing. The analysis also demonstrates that, while a policy of complete bill and keep might give rise to certain inefficiencies, the policy proposed by AirTouch - which mandates cost sharing for some facilities and relies on private negotiations subject to ground rules set by the Commission - would not.

III. THE COMMISSION SHOULD NOT ALLOW THE *STATUS QUO* TO CONTINUE

A. The Current System of LEC-CMRS Interconnection is Fundamentally Flawed

Despite LEC claims to the contrary, the current system does not work. The LECs' own economists state that the current system is inefficient in terms of both rate levels and rate structure.[6] There is wide variation in interconnection rate levels among LECs and little reason to believe that these differences are cost-based.[7] Further,

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6 *See, e.g.* Comments of SBC Communications, Inc., Attachment A, Testimony of Jerry A. Hausman at 6-7 (hereinafter "Hausman SBC Testimony"); Bell Atlantic, Attachment 3, Statement of Robert W. Crandall at 8,10 (hereinafter "Crandall Bell Atlantic Statement"); Pacific Bell, Exhibit B, Statement of Jerry A. Hausman 22-23 (hereinafter "Hausman Pacific Bell Statement"); GTE, Attachment B, Testimony of Edward C. Beauvais at 26-27 (hereinafter "Beauvais Statement").

7 For example, in New York, Bell Atlantic NYNEX Mobile pays 2.59 cents per minute to terminate local traffic on a LEC network, while CLECs pay only 0.98 cents per minute. Comments of Bell Atlantic NYNEX Mobile, Inc. at 5. Comcast Cellular is charged \$0.025 per minute by Bell Atlantic, a rate that "is one thousand two hundred and fifty percent (1250%) of the average incremental cost of \$.002 per minute of providing the service." Comcast Corporation at 10, n. 21. Cox Enterprises notes that "The average charge for cellular interconnection is currently 3 cents per minute . . . (A)pplying the highest reported rate for interconnection, some cellular operators are paying more than seventy-five (75) times the average cost of interconnection at 16.4 cents per minute." Comments of Cox Enterprises at 13-14. Century Cellunet notes that ". . . (t)he rates LECs currently charge cellular carriers to terminate mobile traffic are so high that cellular carriers will never be able to offer local exchange service on a competitive basis. For example, Century is charged an average rate of \$0.025 per minute for local interconnection. At that price, Century's interconnection costs alone would be higher than most users pay for local exchange service." Comments of Century Cellunet at 4.

as documented in the comments, current rate structures do not reflect the underlying pattern of costs.[8]

LECs have argued that interconnection rates contain needed subsidy elements, but they have not demonstrated that these subsidies are based on sound policy grounds. Moreover, the fact that LECs are able to extract subsidy contributions under the current arrangements demonstrates that they are exercising market power. Competitive firms cannot demand subsidy payments from their customers.

The LECs are incorrect in asserting that interconnection rates do not affect the competitiveness of CMRS. Interconnection rates will become increasingly important as CMRS providers attempt to compete in the provision of local loop because a new low-price, high-volume business model will have to be adopted.[9] The relevant measure is not the percentage of cost due to interconnection charges. Interconnection charges should be

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8 For example, Bell Atlantic NYNEX Mobile pays the same per-minute rate for all calls regardless of time of day, in contrast to CLECs, which pay the LEC rate at discounts of up to 70 percent for calls made during off-peak calling periods. "These disparities have no rational cost basis, since a LEC's costs to complete a call received from BANM should be no higher than its costs to complete calls received from other carriers." Comments of Bell Atlantic NYNEX Mobile, Inc. at 5-6; *see also* Comments of AirTouch, Appendix A (setting forth examples of interconnection terms that do not account for differences in traffic flow or geography).

9 LECs have argued that the large bids for PCS show that current interconnection arrangements are satisfactory. This inference is unwarranted on several grounds. First, the LECs provide no evidence regarding bidders' expectations regarding interconnection reform. Second, it may well be that the bids would have been even higher had bidders been confident that LECs would be limited in their ability to exercise market power in setting interconnection rates. In any event, the issue before the Commission is not whether PCS providers have business cases with positive net present values; the issue is how to promote efficient interconnection pricing and increased telecommunications competition, particularly in the provision of local loop services.

measured against overall margin, and margins are going to fall dramatically with the introduction of several new competitors and dramatically increased digital capacity.

1. Interconnection Charges Are A Growing Proportion of CMRS Costs

Several commenters, such as Bell Atlantic, oppose bill and keep on the basis of interconnection charges' relationship to total CMRS costs and retail prices. Bell Atlantic argues that CMRS interconnection payments to LECs are sufficiently diminutive that their elimination would only reduce CMRS retail rates by "about 3%," and that such an "insignificant rate reduction would not make wireless service competitive with landline service."[10] This argument is flawed because it understates the significance of interconnection charges to overall CMRS costs, and because it fails to acknowledge the requirements of CMRS' transition to a local loop competitor.

Cellular providers currently have a cost structure which reflects several large components, particularly depreciation and marketing costs. Due to the capital requirements of system construction and switch purchases in what is still a young industry, depreciation is a sizable expense which makes up as much as 30% of a provider's total costs. Included in this depreciation cost are all network facilities, including microwave backhaul links and other transport facilities. Depreciation costs in fact serve as a partial surrogate for interconnection charges paid to LECs. Thus, the proportion of CMRS total costs influenced by noneconomic interconnection charges extend beyond the per-minute payments.

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[10] Comments of Bell Atlantic at 11; *see also* U S WEST at 16; GTE at 5.

Marketing expenditures constitute about 40% of current cellular costs, primarily as a result of the resources dedicated to cellular subscriber acquisition. As the Commission's David Reed has pointed out, cellular subscriber acquisition costs have been as high as $300 to $800 per subscriber.[11] Yet both depreciation and marketing costs are currently falling and will continue to do so. In fact, the increasing penetration of cellular service, along with the emergence of facilities-based PCS competition, will usher in cost structure changes so dramatic that an entirely new business model for wireless service will be created. Economies of scale resulting from expanded use of the existing network will reduce capital expenditures and corresponding depreciation expenses for cellular incumbents. Marketing costs will fall as customer acquisition expenditures are forced down due to new approaches to distribution.

Unless restructured, interconnection expenditures will increase as a relative proportion of cost. On a per-minute basis, they provide the bulk of a CMRS provider's technical costs, and capture no economies as the network expands to serve more customers. As a result, the ability of cellular providers to become full participants in local loop service competition will be constrained.

As the Commission has recognized in several recent proceedings, CMRS rates are falling significantly and are expected to come down even further.[12] This decline

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11 David P. Reed, *Putting It All Together: The Cost Structure of Personal Communications Services*, OPP Working Paper No. 28, 51 (Nov. 1992).

12 *See In re Petition of CPUC to Retain Regulatory Authority over Cellular*, PR Docket No. 94-105, Report and Order, 10 FCC Rcd 7486, ¶ 122 (1995); *see also In re Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services*, First Report, 10 FCC Rcd 8844, ¶¶ 23-24 (1995) ("*Annual Report*").

in rates is evident in each of AirTouch's markets, where a wide variety of pricing plans reflect a range of consumer needs. High volume users enjoy significant per-minute savings through certain plans, reflecting both their value to the company and the lower costs per minute of serving such customers. As rates continue to fall and mobile usage increases, the per-minute proportion of costs attributable to interconnection will increase significantly.

The following examples select the lowest per-minute charges available from various AirTouch rate plans for certain users today. In Los Angeles, AirTouch Cellular offers an "After Hours Value Plan" with off-peak rates of $.15. In Sacramento, government subscribers pay under $.11/minute for off-peak, and others pay $.15/minute off-peak. In San Diego, under another plan available to corporate accounts ordering 500 subscriptions, peak service is $.23/minute and off-peak is less than $.12/minute. AirTouch Cellular San Diego also offers a 1000 Minute Off-Peak Promotion, which enables callers to pay as little as $.03 a minute for the first 1000 minutes during off-peak hours.

These examples demonstrate that interconnect charges of $0.03 (with no distinction between peak and off-peak) are far from trivial costs. Nor are such rate packages unusual. As the Commission has noted, packages aimed at people who want to use their cellular telephones for a substantial amount each month are proliferating.[13] These packages typically have high monthly access charges in exchange for a large number of "free" or low per-minute charges. As CMRS providers increase their

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[13] *Annual Report*, *supra* note 12, at ¶ 24.

provision of wireless local loop services, the transition to wireless usage at today's wireline usage levels will lead to even more low per-minute price plans.

2. LECs Have Failed To Provide Mutual Compensation for CMRS Interconnection

As stated in the NPRM, the Commission requires LECs to offer CMRS providers interconnection not only "on reasonable terms and conditions," but "under the principle of mutual compensation."[14] Numerous LECs argue that existing interconnection agreements are successful in ensuring that such Commission-required mutual compensation is being provided. BellSouth, for example, states that "[T]his system of negotiated interconnection agreements, arrived at with an understanding of FCC policies, has worked well."[15] Ameritech argues that current "negotiated LEC-to-CMRS interconnection arrangements . . . reflect the principle of mutual compensation for termination of traffic."[16]

Many LECs, however, are *not* providing mutual compensation, some by their own admission. GTE states that "[I]n past negotiations, GTE has supported mutual compensation, *but only when the compensation was adequate.*"[17] Pacific Bell acknowledges that "[T]he Commission currently requires Mutual Compensation for LEC-to-CMRS interstate traffic . . . the Commission's current access charge rules make

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14 *NPRM*, *supra* note 2, at 3.

15 Comments of BellSouth at 16.

16 Comments of Ameritech at 3

17 Comments of GTE at 18 (emphasis added).

its Mutual Compensation requirement meaningless."[18] Although it has not done so to date, Pacific Bell intends to "begin negotiating with CMRS providers in April of this year for Mutual Compensation agreements . . . ."[19] Pacific Bell's belated compliance efforts began on March 1, 1996 with a letter to all cellular and ESMR carriers in Pacific Bell's territory.[20] However, even in the March 1 letter to which Pacific Bell cites,[21] it is clear that the promised mutual compensation arrangements will not soon be forthcoming. Delays may be expected as a result of (1) changes to "existing wireless interconnection agreements," (2) changes to Pacific's "billing and network," and (3) "possible price changes."[22]

By such statements and admissions, the LECs demonstrate both their unwillingness to subscribe to Commission directives and their attempts to delay mutual compensation as long as possible. Bill and keep is necessary to foreclose continued LEC non-compliance and ensure that CMRS providers are not constrained from competing in the local loop. Reliance on private negotiations, without a public policy framework that forces LECs to bargain toward efficient agreements in a timely fashion, will allow the LECs to delay meaningful reform of LEC-CMRS interconnection rates, particularly for PCS. This delay will harm both CMRS providers and consumers.

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18 Comments of Pacific Bell at 6.

19 *See* Comments of Pacific Bell at Exhibit A.

20 *Id.*

21 *Id.*

22 *Id.*

B. Even If It Relies on Private Negotiations, the Commission Must Promulgate Rate Standards

Whether or not the Commission decides to rely on private negotiations in the first instance, it is important to provide guidance to the private parties with respect to what constitutes an acceptable agreement. Even when calling for extensive reliance on negotiations, two members of the Commission staff noted that

> [t]he Commission's role is not eliminated through the use of negotiations because neither negotiating party may have any strong incentives to protect third party interests. Thus the Commission is left with the residual responsibility of protecting the public interest (including the interests of potential competitors).
>
> A key element of the Commission's role in negotiations is its responsibility to set the framework within which bargaining will take place where an agreement will most likely be economically efficient. To best fulfill this aspect of its role, the Commission must recognize and cultivate incentives to bargain.[23]

The economic theory of bargaining clearly demonstrates that "threat points" are critical to bargaining. That is, each party's strength in negotiating an agreement depends in large part on how that party would fare if no agreement is reached. Economic theory identifies at least two costs of failing to reach an agreement at a given point. One, the entire negotiation might break down. Two, even if negotiations continue, there often are costs associated with delay.

The current threat points give rise to highly unequal bargaining positions and the exercise of LEC market power. The alternative of perpetuating interminable negotiations and foregoing necessary interconnection may force CMRS providers prematurely to agree to uneconomic interconnection just to ensure the carriage of necessary traffic. This accounts for the overpriced interconnection agreements that exist today. In the absence of an interconnection agreement, the LEC can largely continue

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23 Morris and Preece, *Negotiating for Improved Interconnection: The Incentives to Bargain*," OPP Working Paper No. 7, 4 (Jan. 1982).

with business as usual, while most CMRS providers would be forced out of business. Hence, the costs of a breakdown in negotiations are much lower to LECs than to CMRS providers. Moreover, in light of the fact that CMRS providers are potential LEC competitors, bargaining breakdowns or delays might, from the LEC perspective, be benefits rather than costs.

Generally, bargaining disputes are little more than arguments over the division of economic rents. If that were all that were at stake here, there would be little public interest concern. But the bargaining over LEC-CMRS interconnection rates is about more than the division of rents. For a variety of reasons, LECs have incentives to force CMRS providers to accept inefficient arrangements that reduce the total social benefits derived from telecommunications services.

There are several reasons why the bargaining outcome is likely to be inefficient in the future, as it has been up to the present. First, the bargaining takes place under conditions of asymmetric information. That is, each party possesses information about itself (*e.g.*, interconnection costs and benefits) that the other does not. This fact implies that a LEC cannot rely on lump-sum charges to efficiently transfer economic rents to itself from CMRS providers. Instead, a LEC needs to rely on metering, whereby prices are set above cost so that high-volume customers — who presumably derive greater benefits from interconnection — make a contribution to LEC profits. While profitable for the LEC, from a public interest perspective, this practice gives rise to overly high per-minute and dedicated facility rates.

Ironically, public policy can also create incentives to implement inefficient pricing schemes. For a variety of sound reasons, public policy limits the practice of price discrimination. Consequently, the use of lump-sum payments that varied across CMRS providers might be prohibited on the grounds that it would be discriminatory. This may drive LECs to offer the same nonlinear pricing schemes, such as two-part tariffs, to all interconnectors. By setting the traffic-sensitive component of a two-part tariff above margin or cost, a LEC may be able extract greater rents from higher volume CMRS providers, who presumably receive a greater value from the interconnection. While setting the traffic-sensitive charge above marginal cost may maximize LEC profits, it does not maximize social benefits. Setting the traffic-sensitive charge above marginal cost inefficiently suppresses calling volume.

Adverse effects on third parties present another reason why LECs may bargain for inefficient interconnection agreements. By delaying interconnection or raising its costs, LECs may be able to stifle or slow competition. The gain to the LEC from delaying competition may exceed the loss to its potential CMRS competitors. But this does not mean that the delay is efficient or in the public interest. To assess the public interest, one must take into account the effects of delay on efficiency and consumer welfare. Consumers will be harmed by the resulting lack of competition, higher prices and lower rates of innovation. Hence, public policy makers cannot simply rely on private negotiations to develop efficient agreements that maximize the total benefits derived from telecommunications services.

In light of the unequal bargaining power and the incentives for LECs to negotiate inefficient interconnection arrangements, the public interest is best served by having a pro-competition (not pro-competitor) threat point defined by Commission. The co-carrier policy recommended in these reply comments provides that threat point. The Commission should direct LECs and CMRS providers each to designate a single point of interconnection for each defined service area. These designated points would serve as the boundaries of the respective networks. Each carrier should be responsible for the costs associated with transmission and switching within its network. The Commission should mandate bill and keep for transmission and switching within each respective network, and the 50-50 sharing of dedicated facilities interconnecting the two networks.

To promote efficiency, the private parties should be allowed to negotiate any modifications to these baseline arrangements that they find mutually beneficial. For example, in an area with high volumes of interconnected traffic, a LEC and CMRS provider might want to negotiate multiple points of interconnection, such as running dedicated facilities between multiple MTSOs and LEC end offices.

IV. LEC ARGUMENTS AGAINST BILL AND KEEP ARE MISPLACED

In support of their position, the LECs make a number of claims arguing against implementation of bill and keep. They fail to note that many of the same points hold with equal force under the current regime whose continuation they advocate. Moreover, while a policy of complete bill and keep might give rise to inefficiencies, that is not what AirTouch and other CMRS providers are arguing is the correct policy. As discussed below, there are some elements of interconnection for which it is efficient to have explicit cost sharing between wireline and wireless co-carriers. In the remainder of this section, we discuss several of the leading LEC claims in turn.

A. LECs Overstate Claims that Bill and Keep Will Send Price Signals that Distort Consumption and Investment Decisions

Any interconnection policy generates prices that send signals which guide consumption and investment decisions by end-users and service providers. Consider first the effects on consumption. The LECs claim that bill and keep will distort consumption.[24] Yet the LECs also claim that the CMRS providers charge rates significantly above their incremental costs and that interconnection costs are a small part

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24 *See, e.g.*, Comments of Bell Atlantic at 2, 6-8; Pacific Bell at iv, 58; Bell South at 21-22, 27; GTE at 37.

of CMRS costs.[25] Hence, by the LECs' own logic, there is no danger that CMRS retail prices will be below cost, regardless of how interconnection is priced. There is a much greater risk from overpricing than from underpricing. The LECs' economists agree that pricing interconnection above long-run incremental cost (as under the current regime) distorts consumption choices downward.[26]

The LECs also argue that bill and keep will distort CMRS investment in terms of where they interconnect with LEC facilities.[27] The LECs claim that CMRS providers will free-ride on LEC investments by making excessive use of LEC facilities instead of constructing substitute facilities of their own.[28] LEC concern for investment misincentives is both newfound and misplaced.

LEC concern is newfound because the massive distortions inherent in the current system of interconnection pricing do not seem to have concerned the LECs to date. As documented by several commenters in this proceeding, LECs have imposed LEC-CMRS interconnection rate structures that bear little relationship to underlying costs.[29] Just as underpricing services can distort investment incentives, so can overpricing. Moreover, current pricing structures do not reflect the underlying pattern of cost causation. Existing interconnection arrangements do not take into account

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25 *See, e.g.*, Comments of Bell Atlantic at 11-12; GTE at 5, 38; U S WEST at viii, 34; Pacific Bell at 63.

26 *See, e.g.*, Hausman SBC Testimony, *supra* note 6, at 5; Crandall Bell Atlantic Statement, *supra* note 6, at 7; Ameritech, Attachment B, Statement of Kenneth Gordon at 11 (hereinafter "Gordon Ameritech Statement").

27 *See, e.g.*, Comments of Pacific Bell at 12-13; SBC at iv, 9-11; Bell Atlantic at 7; BellSouth at 28

28 *See, e.g.*, Comments of Pacific Bell at 12-13; SBC at 9-11.

29 *See supra* notes 7-8 and accompanying text.

differences in traffic flows as measured by volume, geographic distribution and temporal distribution.[30]

LEC concern is misplaced because LECs are attempting to apply current pricing structures to LEC facilities which CMRS providers can not presently use to substitute for their facilities. The whole reason for LEC-CMRS interconnection is that CMRS must rely on incumbent LECs for local switching and local loop connections to end users. For these facilities, there are no CMRS investment incentives to distort.

In theory, at least, the use of bill and keep for the facilities connecting a LEC's network with the CMRS provider's network would induce a CMRS provider to locate its point of interconnection with the LEC too far from the LEC's point of interconnection: the CMRS provider would not bear any of the additional costs of interconnection. It is precisely to avoid this problem and give each party incentives to reduce the costs of interconnecting the two networks that AirTouch has recommended that these dedicated facilities be subject to 50-50 cost sharing.

LECs also argue that bill and keep for common transport and tandem switching will lead to inefficiency because CMRS providers will deliver traffic to a LEC's tandem rather than its end offices even when the latter arrangement is more efficient in terms of overall costs borne by the interconnecting carriers. In making this argument, the LECs are implicitly rejecting the use of private negotiations, although this is the cornerstone of their proposed policy. Under the public policy outlined in these reply comments, private parties would be free to negotiate any interconnection arrangements that they choose. If a LEC believes that a CMRS provider, or even some other carrier, can carry traffic between the CMRS network and the LEC's end offices

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30 *See generally* Comments of AirTouch, Appendix A (setting forth examples of specific interconnection terms that do not account for differences in traffic flow or geography).

more efficiently than can the LEC itself, then the LEC is free to make these alternative arrangements. By setting a baseline pursuant to which each co-carrier is responsible for what happens to traffic within its network, the policy recommended by AirTouch gives each co-carrier incentives to minimize the costs of carrying that traffic.

It is important to note the contrast between: (1) negotiations over basic interconnection pricing levels and whether to interconnect at all; and (2) negotiations over the specific facilities used to carry out interconnection. The former implicates the welfare of third parties (*e.g.*, consumers and potential entrants), which gives rise to a direct public interest in the outcome of the negotiations. Negotiations over the specifics of which facilities to use to interconnect will affect the profits of the two parties, but are much less likely to be of direct consequence for third parties. Thus, in general, private negotiations of specific arrangements can be expected to promote efficient outcomes, given that public policy has firmly established the baseline obligation to interconnect.

The final potential incentive effect of bill and keep is on LEC investment in local network facilities. In their comments, LECs argue that bill and keep will undermine their investment incentives.[31] However, LEC investment is driven by a large variety of factors and it is implausible that these amounts would really matter. The LECs say LEC-CMRS interconnection is too small to matter to CMRS, so how could it matter to much larger and more diversified LECs? While bill and keep might have non-negligible effects on facilities constructed solely to provide interconnection, these facilities would be subject to explicit cost sharing — not bill and keep — under the AirTouch proposal.

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31 *See, e.g.*, Comments of Pacific Bell at 12-13, 60-61; SBC at 9-11; BellSouth at 28; Bell Atlantic at 7.

Lastly, concern for investment incentives also indicates continued regulatory oversight will be needed to ensure that LECs do not strategically under invest in interconnection facilities to disadvantage potential rivals.

B. LECs Mistakenly Claim Bill and Keep Is an Unwarranted Subsidy Or Even a Taking

In their comments, LECs claim bill and keep is an unwarranted subsidy or a taking.[32] At a minimum, this claim is rather ironic. For years, LECs have refused to provide reciprocal compensation, have demanded payments from one-way paging although all of the traffic flows from LEC networks to paging networks, and have admittedly charged rates in excess of costs. The LECs have been happy to use LEC-CMRS interconnection to subsidize other ratepayers and LEC shareholders, and to deny CMRS providers explicit compensation for the use of their facilities.

The rationale for imposing bill and keep is not that it is a subsidy. Rather, it is a recognition of the fact that both LEC and CMRS networks benefit from interconnection (which the LECs themselves acknowledge), and that the costs of rate development and billing may exceed the social benefits of charging explicit rates.

The imposition of bill and keep also would not result in a "taking," as the LECs suggest. The taking concept typically contemplates a physical possession which is not present here.[33] Beyond this, however, the LECs do receive adequate compensation in

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32 *See, e.g.*, Comments of Bell Atlantic at 8-9; GTE at 13-15; Pacific Bell at 79-86; BellSouth at 18-20; U S WEST at 50-53.

33 *See* Joint Comments of Sprint Spectrum and American Personal Communications ("Comments of Sprint Spectrum/APC") at 26-27 *citing Lucas v. South Carolina Coastal Council*, 112 S.Ct. 2886, 2895 (1992) (being forced to forego all economically beneficial uses of one's property constitutes a taking); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982) (finding direct physical attachment of equipment to appellant's building a taking since it was a permanent physical occupation of appellant's property); *Penn Central Trans. Co. v. New York City*, 438 U.S. 104 (1977) (a taking can more readily be found when (continued...)